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No. 82-

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH COBY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether Section 1341, Title 28, United States Code, removes from the federal court's jurisdiction a suit to enjoin and restrain the assessment and collection of a California Franchise tax, where it is not "plain" that the complainant has any judicial remedies available to it in the California courts to contest the amount of the tax or even to raise constitutional issues.

2. May the State of California burden foreign commerce by extending the combined unitary income formula (hereinafter "combined formula") which it applies to an American corporation to include the income, property and wages of its United Kingdom parent corporation and the latter's 71 non-U.S. subsidiaries operating worldwide, which have foreign commerce with the United States but which do no business in any state of the United States, which do not have a permanent establishment in the United States, which are not subject to taxation by the United States Government under either the Internal Revenue Code or the United States-United Kingdom Income Tax Convention, and where the effect of the State's application of its formula is to apportion some of the income of the nonresident United Kingdom corporation and its non-United States subsidiaries to the American subsidiary for taxation by California where:

(a) The income of the United Kingdom corporation and of its non-U.S. subsidiaries which is included in the combined unit California would apportion, has already been taxed by the United Kingdom and the other host countries, and California allows neither a deduction for those taxes nor a credit for them against its own tax, thus producing multiple taxation of income earned in foreign commerce; and

(b) The income of petitioner, the American subsidiary, is swollen by the apportionment to it of some of the income of the United Kingdom parent and its non-U.S. subsidiaries, far beyond any conceivable earning capacity of the American subsidiary from the conduct of its own business; and

(c) The apportionment of the combined net income by the three-factor formula of the ratio of California property, payroll and sales to the combined world-wide property, payroll and sales of the United Kingdom parent and its seventy-six subsidiaries, is made on the basis of estimates, first because the Official Secrets Act of the United Kingdom prohibits the United Kingdom corporations from revealing some of the information essential to the application of the California formula, and second because the wages paid by the non-U.K. subsidiaries are not reported to the United Kingdom parent and are for years before California made its demand and cannot now be assembled; and

(d) There is no uniformity between the economic environment in which the American subsidiary operates and those in which the non-U.S. corporations operate, most notably because the wage rates in the United States for the years before the Court are higher than those which prevail in the countries in which the corporations which California would consolidate operate, with the result that each factor in the formula is weighted to apportion more net income to California than could be earned in that state by the business conducted in it, such income being therefore derived from that properly taxable by the United Kingdom and the

other foreign countries where the businesses are conducted; and

(e) where the businesses of the United Kingdom parent, its non-U.S. subsidiaries, and the American subsidiary which are being combined consist primarily of the recording in each country of music popular in and often peculiar to that country, the making of records and tapes in the country in which the recording was made, and the sale of those records and tapes to the residents of that country, but sales of records in foreign commerce are made by both the U.K. parent and petitioner, the American subsidiary, to customers of their choice, and under a reciprocal matrix exchange agreement both the U.K. parent and the American subsidiary make records of music initially recorded by the other; and

(f) where the effect of the California formula is to tax to petitioner, the American subsidiary, income earned and received exclusively abroad by other corporations from business conducted locally in other countries or in foreign commerce, which income California would not have jurisdiction over directly because of the Due Process Clause, of International Law, of the United States-United Kingdom Income Tax Convention, and of Section 381, Title 15, United States Code.

3. Is California's use of the combined formula in the circumstances contrary to the Due Process clause, the United States-United Kingdom Income Tax Convention then in effect, and International Law?

PARTIES TO THE PROCEEDINGS BELOW

There is no other party to this proceeding. EMI Limited is a party to a companion but unconsolidated case which the Court of Appeals remanded to the District Court for further proceedings. On October 8, 1982, the District Court dismissed the EMI case. An appeal will be but has not yet been filed, and a petition for certiorari will be but has not yet been filed.

EMI Limited stock is owned in the United Kingdom.

Petitioner has no partially owned subsidiaries.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Capitol Industries-EMI, Inc., a Delaware corporation, petitions for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, to review its decision rendered February 16, 1982, petition for rehearing denied and opinion amended July 22, 1982. A second petition for rehearing was filed on July 27, 1982 and denied on September 7, 1982.

OPINIONS BELOW

The opinion of the Court of Appeals was released for publication on July 22, 1982, and is reported at 681 F.2d 1107. It is reproduced in Appendix A, attached hereto. The District Court filed an opinion, which is unpublished. It is set forth in Appendix B.

JURISDICTION

The jurisdiction of this Court is invoked under Section 1254(1) of Title 28, United States Code.

The jurisdiction of the federal court was invoked under Sections 1331 and 2201, Title 28, United States Code. Petitioner contends that it does not have a plain, speedy and efficient judicial remedy available to it in the California courts, and for that reason the provisions of Section 1341, Title 28, United States Code, do not remove this case from the jurisdiction of the federal courts.

STATUTES, CONSTITUTIONAL PROVISIONS AND TREATIES INVOLVED

1. The sections of the Judicial Code involved are Sections 1331, 1341 and 2201, Title 28, United States Code. They are set forth verbatim in Appendix C.

2. The sections of the United States Constitution involved are the Commerce Clause (Art. I, Sec. 8, cl. 3), the Due Process Clause (Amendment 14, Sec. 1), the Import-Export Clause (Art. I, Sec. 10, cl. 2), and Art. I, Sec. 8, cl. 1 and 10, and Art. I, Sec. 10, cl. 1 and 3; and Art. II, Sec. 2, cl. 1 and 2, Art. III, Sec. 2, cl. 1 and 2, and Sec. 3, cl. 1 and 2, and Art. VI, cl. 2 and 17. All are set forth in Appendix D.

3. The United States-United Kingdom Income Tax Convention in effect in the years involved in this case. The text of the relevant provisions is set forth in full in Appendix E.

4. Section 381 of Title 15, United States Code, is also involved. Its text is set forth in Appendix F.

STATEMENT OF THE CASE

This case is one to restrain defendant tax officials of the State of California from assessing a tax against plaintiff, Capitol Industries-EMI, Inc., on a portion of the income of its parent, EMI Limited, and the latter's 71 non-US subsidiaries from their business not done in the United States but done exclusively in foreign and local commerce from and in the United Kingdom and other foreign countries, in violation of the United States Constitution, and a federal statute, of a United States treaty, and of International Law.

Petitioner Capitol Industries-EMI, Inc., is a Delaware corporation, and is a subsidiary of EMI Limited, a corporation of the United Kingdom. That corporation owns all or substantially all of the stock of 76 subsidiary corporations, some of which are formed under the laws of the United Kingdom, and others of which are formed under the laws of the various countries in which they operate. They operate in and are formed under the laws of more than 30 countries in Western Europe, North America, the Near East and the Far East of Asia, South America, Africa, and Australasia. Capitol Industries-EMI, Inc. (hereinafter "Capitol"), is one such subsidiary, and has been since EMI Limited acquired a majority of its stock in 1956. Capitol has its principal office and plant in Holly-

wood, California, and has other plants in Illinois, Virginia and Connecticut.

Capitol makes and sells phonograph records and pre-recorded tapes of music recorded in its studios and in independent studios by artists under contract to it. These artists are selected by Capitol, and the music recorded is selected by Capitol, or by Capitol and the artists. EMI has no role in Capitol's selections of artist or music. Capitol sells its records nationally and internationally, through outlets with whom it establishes contractual relationship. Its sales are to the trade. It also has its own licensees in foreign countries who make and sell records in their countries from Capitol matrices. EMI Limited does not direct or participate in any of these activities and arrangements.

EMI Limited does not do business in the United States and does not have a permanent establishment in this country. It is therefore not subject to United States tax by treaty and international custom. In its corporate self it does no business outside of the United Kingdom. EMI's worldwide subsidiaries make approximately 20% of all of the phonograph records made in the Western world and own pressing plants located in 13 countries. Capitol in the United States owns three of these plants. In addition to that type of music business, through subsidiaries operating in several countries, but not in the United States, the EMI group is in the business of retailing phonograph records and pre-recorded tapes, and sheet music.

Subsidiaries of EMI also operate a variety of other businesses: the manufacture of television cameras, antennae and transmission equipment, and of security devices; the operation of a movie studio at which both television

films and films for the theater are made; the operation of movie theaters, bingo parlors, hotels, restaurants, and places of amusement; the manufacture for the government of the United Kingdom and certain governments of NATO of military equipment, much of which employs radar principles pioneered and in some instances invented by EMI, and the development and production of equipment in the field of medical electronics, the most notable of which is the invention and patenting of the brain scanner and body scanner. Capitol conducts no business other than the making of phonograph records and pre-recorded tapes, and at times the manufacture and sale of raw tape for use by other recording companies.

EMI does operate in foreign commerce between the United Kingdom and the United States. Its subsidiaries sell completed phonograph records to an unrelated United States outlet, but not to Capitol. It and its subsidiaries have a matrix exchange agreement with Capitol, modeled closely after the one which EMI Limited had with RCA before EMI acquired controlling interest in Capitol, under which each party has an option to license a duplicate matrix of recordings made by the other, to make recordings of the music embedded on that matrix and to sell them in their marketing areas. This agreement is entirely reciprocal, giving EMI precisely the same rights in respect to matrices of music recorded by Capitol as it gives Capitol for matrices made by EMI. The agreement confers an option right on each party, and does not bind either party to take any of the matrix offerings of the other. The license fees and other amounts paid for the privilege are entirely reciprocal, so that the amounts paid by Capitol to EMI are the same as the amounts paid by EMI to Capitol, per unit manufactured.

Both EMI and Capitol contend that they are not engaged together in a single unitary business, and that the income of each can be readily ascertained by the arm's length method used by the United States Government under Section 482 of the Internal Revenue Code, and by all foreign governments. They also contend that taxing Capitol on an apportioned amount of EMI's income represents a forbidden burden on foreign commerce and denial of due process, contrary to the Constitution of the United States, and contrary to International law, to the United States-United Kingdom Income Tax Convention, and to Section 381, Title 15, United States Code.

Defendants initiated their audit of Capitol's returns by demanding information of EMI Limited, threatening it with monetary penalties if it did not reply.[1] EMI informed them that it was not within the jurisdiction of California, could not supply some of the information sought because of restrictions of the Official Secrets Act of the United Kingdom, and did not possess other of the information sought because it was not supplied to EMI by EMI's non-U.K. subsidiaries. Defendants then made the same request for information of Capitol, with the same threat of a penalty, and Capitol informed defendants that it could not supply information about EMI which it could not get from EMI. Defendants' employees then compiled figures about EMI available from public sources in the United States, and assessed a proposed additional tax against Capitol based upon what they believed to be the

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[1]The Court of Appeals stated in a footnote that the demand was made only on Capitol. The court's remark is contrary to three affidavits in the record and is not supported by any affidavit or other evidence.

total net income of EMI and all of its worldwide subsidiaries, and an apportionment of it to California based upon the ratio which the California property, payroll and sales of Capitol bore to what defendants estimated was the total worldwide property, payroll and sales of EMI and its subsidiaries. The non-U.K., non-U.S. property and payroll figures were unknown and defendants substituted their estimates. Capitol protested this action, conferences were held by Capitol representatives with defendants and their representatives, and those representatives informed Capitol that defendants would adhere to their position, until such time as Capitol provided the information defendants had sought from EMI. EMI Limited, and Capitol Industries-EMI, Inc., both then filed cases in the United States District Court for the Northern District of California against the defendants, to restrain such an assessment against Capitol, and in EMI's case to restrain defendants from lessening the value of EMI's investment in the United States, through the assertion of unconstitutional taxes from Capitol, from burdening EMI's foreign commerce with the United States, and for other relief.

Cross-motions for summary judgment were filed, in petitioner's motion supported by extensive affidavits of officers of EMI and Capitol, and documentary exhibits. While these cases were pending, defendants' representatives proposed to Capitol's representatives that defendants would change the basis of assessment, to combine Capitol only with EMI's music business. Capitol's representatives informed defendants' representatives that the information they needed for such a modified combination and apportionment was not available, so the representatives of defendants devised figures based upon assumptions and estimates and em-

ployed those in the apportionment formula in substitution for the figures that they had previously used, which had been their estimate of the entire worldwide business of EMI Limited. The effect was to reduce the deficiency, but a deficiency in excess of $400,000 still remains in issue for the years determined by defendants, and an unknown but certain amount for later years. On December 7, 1981, while this case was submitted and awaiting decision in the Court of Appeals, defendants mailed notices of final assessment so computed. Petitioner has obtained a stay of collection by filing an appeal with the State Board of Equalization.

The District Court rendered summary judgment for defendants, holding that petitioner had an adequate remedy in the California courts. Appeal was taken, and the Court of Appeals also held that petitioner had a "plain, speedy and efficient" remedy in the state courts, and remanded the case for dismissal. The merits were not considered.

REASONS FOR GRANTING THE WRIT

1. This Court should grant the writ in order to declare that it has not held that § 1341, Title 28, U.S. Code, renders § 1331 and § 2201 of the same title dead letters in state tax cases. The court below seems to think otherwise, because it has construed this Court's prior decisions as dispensing with the statutory requirement that the state court remedy, to be a disqualifying one for federal jurisdiction, must be "plain". This Court has held that the efficiency of the state remedy must be "plain", in two decisions it has not overruled, *Atlantic Coast Line R. Co. v. Daughton;* 262 U.S. 413, 426 (1923); *Hillsborough Township v. Cromwell,* 326 U.S. 620, 625 (1946). The decision below is in conflict with them. It is "plain" that the California state

court remedy is questionable, at best. The precise limits of judicially created doctrines are always difficult to predict and the California doctrine of exhaustion of administrative remedies as a condition precedent to relief in the courts is a judicially established doctrine, without statutory foundation indicating what its limits are. The California courts have been steadily expanding the doctrine, and it has been applied in two tax cases in the California courts in a manner which raises the most serious question about whether petitioner would have an "efficient" remedy in those courts.

Petitioner has been unable to supply some of the information demanded by defendants' staff, and defendants accordingly made estimates and assessed tax based on them. The information sought was about sales, property and payroll of EMI and its non-United Kingdom subsidiaries from the music business and EMI could not supply petitioner with that information, party because some of that information was about its foreign subsidiaries, who did not classify it, and party because the British Official Secrets Act forbade it. At least the latter bar may be removed with time, but under California doctrine information subsequently available could not be used at the trial. Effectively this would prevent petitioner's challenging the computation and under a recent state decision the earlier failure to supply is a fatal jurisdictional bar to any relief, even on constitutional grounds.

In *West Publishing Co. v. McColgan*, 27 Cal.2d 705, 166 P.2d 861, 865 (1946) affirmed on other grounds, 328 U.S. 823, the California Supreme Court held that evidence which the taxpayer had not presented to the administrative agencies could not be introduced in court in a refund action challenging the administrative conduct. The result was to

prevent the taxpayer from questioning the amount of the assessed tax, though the court did proceed to consider the taxpayer's constitutional arguments. More recently, however, in *Barnes v. State Board of Equalization*, 118 Cal. App.3d 904, 173 Cal.Rptr. 742 (1981), hearing denied, the California Court of Appeal even refused to permit the taxpayer to present its constitutional points. The reason was the same as in *West*, that the taxpayer had neglected to supply information requested by the State Board of Equalization while the case was in the administrative process.

The Court of Appeals below has construed both cases in its opinion in a manner which limits them severely, and the court was apparently under the impression that it had the power to instruct the California courts how to interpret their own precedents. Unfortunately for this petitioner, however, the California courts are at liberty to define the doctrine of exhaustion of administrative remedies according to their own concepts, and are not bound by the interpretation of a federal court. The Court of Appeals erred in believing that it could define the state doctrine in a way which would govern the state courts in a later proceeding involving this petitioner.

The Court of Appeals could not deny that the two California cases did hold that evidence not presented to the administrative agency could not be presented later in court, or that the *Barnes* case held that the requirement was jurisdictional and prevented the court from considering any of the taxpayer's arguments on the merits, even constitutional arguments which were unrelated to the facts not presented. The Court of Appeals stated that those decisions would not apply to a taxpayer such as Capitol which failed

to introduce evidence for the administrative agencies which it had no power to obtain and offer, and speculated that if Capitol succeeded in obtaining further information from EMI, at a subsequent date, it could then successfully offer that information or evidence in a state court action. There is, unfortunately, not a whit of suggestion in the *Barnes* opinion that that view is correct. Furthermore, it would have to depend upon whether the California courts agreed that EMI had properly construed the Official Secrets Act of Great Britain. The administrative agency denied that it had. This is a subject which should not properly be presented for consideration by state courts, yet under the view taken by the Court of Appeals of what the California courts meant to hold, it would be of the essence that they decide that Capitol was indeed unable because of British law to introduce or offer the evidence the Franchise Tax Board had requested, and which Capitol sought to introduce at a later date in the state court proceedings.

The record in this case contains several pamphlets in which EMI describes in some detail the role it plays as a defense contractor for the United Kingdom Government, and in a general way the products which it supplies to that government. That revelation was first made by the British Government, and EMI could not have made it until permitted to do so. The future may also bring a relaxation of certain specific prohibitions in the same regard, as the years in question fall further into history and the materials supplied in those years become more obsolete. It might well come to pass that Capitol would be able to supply all the information the Franchise Tax Board requested for its "music-only" formula by the time the case comes to trial in the California courts, but it seems anything but "plain"

that the California courts would permit Capitol to argue its constitutional points or to introduce the newly obtained evidence. That evidence would relate only to amount of tax, of course, but the same is true of the evidence the taxpayer tardily sought to offer in the *Barnes* case, and yet it was held precluded from having its unrelated constitutional arguments considered.

Section 1341 is being stretched in the decision below beyond the limit of permissible interpretation, and this Court should review the decision for the purpose of informing the lower courts that § 1341 is not a restriction absolute in all cases, but only when the state courts do provide a "plain, speedy and efficient" remedy.

A decision from this Court that state courts so restricting their remedy do not remove federal jurisdiction is needed to show the federal courts that § 1341 is not a dead letter, and at the same time it will not open the floodgates because the unusual facts here presented should not find many parallels. Indeed, it would probably serve as a warning to the state courts that they should not create bars to state relief which prevent the remedies they offer from being "efficient."

2.A. This Court has accepted jurisdiction of two cases[3] presenting constitutional issues raised by the application of their combined apportionment formulae by American states to foreign source income of foreign subsidiaries of domestic parent corporations. This case presents another, and vitally important aspect of the same problem: viz, the application of such combined apportionment formulae to

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[3]*Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, Illinois Department of Revenue, No. 81-349, Oct. Term 1982; *Container Corporation of America v. Calif. Franchise Tax Board*, No. 81-523, Oct. Term 1982.

the foreign source income of a foreign parent corporation with an American subsidiary. This aspect of the problem should, if possible, be considered while the Court is considering the other cases.[3] Considerations unique where there is a foreign parent, such as treaties, double taxation of the before-tax income, and the fact the foreign source income of foreign parents will never be paid into the United States, and will never be within the reach of the United States, are considerations the Court should have presented to it on plenary argument, and will not have before it in cases involving American parent corporations. As the Solicitor General pointed out in his amicus brief in *Chicago Bridge & Iron Co. v. Caterpillar*, supra footnote 3, it is the instance of the taxation of the American subsidiary so as to reach the income of the foreign parent which has the international community up in arms. This case is that case, and presents this Court with its only present vehicle for ruling on it directly.

B. The Court has learned from the briefs of the parties and amici curiae in both *Chicago Bridge & Iron* and *Container Corporation* that there is no more serious international controversy involving the United States in the area of taxation than that which has been engendered by the insistence of certain states on applying their combined unitary apportionment formulae to foreign parent corporations and their foreign subsidiaries, and then combining

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[3]Petitioner's companion case, *EMI Limited v. Bennett* et al., formerly in this Court as No. 81-1088, is back in the District Court on remand. The challenge to jurisdiction under § 1341 was rejected in the Court of Appeals, but it ordered, sua sponte, that EMI's standing to sue be examined. A motion to dismiss on that ground was granted and an order of dismissal entered on October 8, 1982. An appeal and a petition for certiorari will both be filed.

them with their American subsidiaries. The protest letters of the President of the European Economic Community, The Netherlands, Canada and others have been presented to the Court, as have the voices of various foreign trade associations.

C. The international community has shown much more concern with the avoidance of duplication of income taxes than it has with the duplication of property taxes. There are presently 40 such treaties, either in effect between the United States and foreign countries c.. .gned and in the process of ratification. The concern this Court expressed in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), about duplication of taxation in foreign commerce and the retaliatory effect that could be expected from permitting a state to impose taxes on foreign commerce which duplicate the tax burden imposed by the home nation, should be even greater here. The duplication of income taxation in the international sphere is an issue repeatedly dealt with in treaties, and international custom of avoiding it has developed even where there are not bilateral treaties. As we will show hereafter, the retaliation which this Court foresaw would follow from the duplication of tax involved in *Japan Line*, if this Court had permitted it to occur, has already occurred in the international income tax sphere. This case is an excellent vehicle for the consideration of the impact of this type of combined formula because the feared duplication of tax exists in fact, and the ultimate equity owner of the income which has been taxed twice is a foreign corporation, formed under the laws of and operating in a treaty nation, and having no permanent establishment in the United States. The impact of any decision in this area involving domestically-owned multinational corporate

groups cannot be fully assessed by this Court without consideration of the possible impact of such a decision on foreign parents of multinational groups which have one or more subsidiaries operating in the United States.

D. In *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court held that the constitutional tests of validity of taxes in foreign commerce differed from those in interstate commerce. Our Nation's formative history explains the necessity of that conclusion, and of the corollary the Court also adopted, that schemes of taxation which do not impermissibly burden interstate commerce may impermissibly burden foreign commerce. Hence apportionment methods valid in taxation of interstate commerce may be invalid when applied to foreign commerce, and this Court's decision in *Japan Line* held that the apportionment of property values there involved, though valid in interstate commerce, was invalid in foreign commerce.

The history we referred to suggests strongly that the prohibition against states' burdening foreign commerce is absolute. Two eminent historians state that the two principal causes of the American Revolution were dissatisfaction with Parliament's control over taxes and over foreign commerce. The first governing law over the United States, the Articles of Confederation, did not substitute another central control over these subjects for the one the Continental Congress was fighting to terminate. 3 Farrand, *The Records of the Federal Convention of 1787* (1911), pp. 547-548; 2 Curtis, *History of the Constitution of the United States* (Harper and Brothers, 1854), pp. 20-22; 1 Curtis, *History etc.*, p. 148. Experience with operating under the Articles soon demonstrated that the Union would not survive long in peacetime if each state remained

free to contribute to the national treasury only whatever it chose, to regulate and to tax foreign commerce, and to make its own treaties of trade with foreign nations. 1 Curtis, History etc., 179-180, 202-213, 276-277; The Federalist XII (Alexander Hamilton). The necessity of removing from the states all control over foreign commerce in order to preserve the Union was perceived, and was a major factor in framing the Constitution, and in gaining adherents to it. The Federalist XLIV (John Jay); The Federalist XI (James Madison); 2 Curtis, History etc., pp. 11-12, 13-14 (footnotes), 23-24. 3 Farrand, *The Records of the Federal Convention of 1787* (1911), Appendix A, CCCCI, 539, 547-548; *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 283 (1976). There was not equal perception that the Congress should also have the power to regulate interstate commerce, but that subject was vigorously debated and the power was conferred only after the persuasion of debate. 2 Curtis, History etc., pp. 289-298. Thus history shows that the Constitutional Convention was absolutely disinclined to tolerate state interference with foreign commerce, and was less concerned wih state interference with interstate commerce.

It follows that the absence of Congressional legislation specifically laying down standards may imply some tolerance of state interference with interstate commerce, but none with foreign commerce.

For this reason, this Court should review the application of State formulae taxing the foreign source income of foreign parent corporations and their subsidiaries to domestic subsidiaries of the foreign parents. This case, where the cleavage between income earned in this country and that earned abroad is unusually distinct, is an appropriate vehicle.

E. The action defendants would take is in violation of the treaty then in effect. The treaty treated laws of the states as laws of the United States and restricted their application to foreign corporations not having a permanent establishment in the United States. Although Capitol is not a direct beneficiary of the treaty, Capitol is the direct victim of its disregard. In view of the obvious reluctance of the federal courts to permit EMI to enforce its own rights, and the unavailability to EMI of any access to the state courts, the treaty rights can apparently be effectively enforced only by Capitol.

F. International law prohibits what defendants seek to do, this Court should so declare, and in this case can do so. In *Japan Line*, the property subjected to multiple taxation had nexus with California through actual physical presence. Here there is an entire absence of nexus. EMI Limited has not property of its own or office in California. Use of the arm's length standard is international custom, and the combined unitary formula is not. Under International law ownership of the stock of Capitol does not establish the presence of EMI in every State in which Capitol operates. International law is based on custom and settled practice as much as on treaties and agreements. *The Paquete Habana*, 175 U.S. 677, 686, 708 (1900); *Sears v. The Scotia* 14 Wall (81 U.S.) 170 (1872); *McCulloch v. Marineros de Honduras*, 372 U.S. 10, 21 (1963); *Statute of the International Court of Justice*, Article 38 (1); *Statute of the World Court*, Article 36. Every state is subordinate to International law. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 425 (1964). The international custom to respect the distinction between foreign parent and domestically formed subsidiary is so thoroughly accepted that it is in

each of the forty income tax treaties the United States has signed and in addition is universally respected between nations where there is no treaty. Thus, for example, Mexico and the United States, and Colombia, Venezuela, Peru, Chile and Spain and the United States all bilaterally recognize the custom in the absence of treaty.

The official position of the Executive about what is prevailing international custom binds the American courts (Draft *Restatement of Foreign Relations Law (Revised)*, American Law Institute, Sec. 132 (3)). The Solicitor General, in response to requests from the Secretaries of State, Treasury and Commerce, and the United States Trade Representative, has informed this Court that the Executive recognizes that international custom mandates the use of the arm's-length method and not the combined unitary formula. He has asked this Court to rule that the international custom should be enforced by this Court. Memorandum for the United States as Amicus Curiae, filed in *Chicago Bridge & Iron Company v. Caterpillar Tractor Co.*, et al., No. 81-349, October Term 1981.

Petitioner has fully discussed the existence of this international custom and its status as international law in the Amicus Brief it filed in concert with its parent, EMI Limited, in the pending case of Container Corporation of America v. Franchise Tax Board, No. 81-523, October Term, 1982, pp. 5-21. Reference to that brief can be made for a full development of the status of this custom as international law.

The importance of this Court's early review of California's departure from International law, in conjunction with the cases it is reviewing, justifies the Court's review of this case.

G. In *Japan Line, Ltd. v. County of Los Angeles*, supra, this Court predicted that foreign governments would be driven to retaliate against the United States if American states were permitted to impose a duplicating tax on property already, and properly, taxed in the home country. California's tax practices typified by what defendants are seeking to do here have already produced retaliation by the United Kingdom. The new U.S.-U.K. Income Tax Convention as signed, and approved by the British Parliament, contained an express prohibition of California's combined formula as applied to United Kingdom parents and their American subsidiaries. The United States Senate approved the treaty except for that provision, which narrowly failed to obtain two-thirds approval. This required that the British Parliament ratify the treaty without that provision, which for two years it refused to do. It insisted on another revision, the Third Protocol, which had the effect of permitting increases in the taxation of American corporations operating in the British North Sea. This was an "additional concession to the British" for "loss of the benefits of Article 9(4)" (the prohibition of State unitary taxation) according to Assistant Secretary Donald Lubick. (Appendix G.) This retaliation is not confined to California's corporations.

There is no assurance other countries will not also retaliate against the California combined formula. There are nine members of the EEC who joined in repeated denunciation of the California practice. Since one has already retaliated, it is reasonable to expect others to do so. Certainly the danger this Court foresaw if the States are free to impose multiple tax burdens on foreign commerce is present here, and this Court should review the permissibility of the California method as soon as possible.

This case provides a suitable vehicle.

H. Independent of Constitutional limitations on the state's power to tax, Defendants are seeking to do by indirection what Congress has forbidden them to do directly. Title 15 United States Code, Section 381. Subsections (a) and (c) of that Code section prescribe the nexus necessary for a state to tax income derived from interstate commerce, and should be applied to prevent a state from importing income from a related foreign entity and subjecting it to tax, where the corporation properly subject to its tax is a self-sufficient and independently operating business entity from the foreign concern.

I. The issue is not precluded by *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271, (1924), which involved a single British corporation doing business in two American states. It could not have claimed protection under the treaty or 15 U.S. Code Sec. 381, neither of which was yet in effect, nor under International custom, which had not yet evolved. Its business was clearly unitary, consisting of making a product in Great Britain and selling it through offices in Illinois and New York, but it offered no evidence of a loss in New York yet claimed one because it showed a loss from its New York and Illinois business combined in its federal tax return. It had clearly submitted itself to the state's jurisdiction, unlike EMI. No subterfuge to reach an exempt corporation was involved.

J. The action of defendants is in conflict with the Due Process Clause, under the recent decisions of this Court in *ASARCO Inc. v. Idaho State Tax Commission*, No. 80-215, October term, 1981, decided June 29, 1982, ... U.S. ....., 73 L.Ed. 2d 787, and in *F. W. Woolworth Co. v. Taxation & Rev. Dept.*, No. 80-175, October term, 1981 decided

June 29, 1982, ... U.S. ....., 73 L.Ed. 2d 819. Under the tests enunciated in those two decisions, the business of petitioner is not unitary with that of its parent corporation, EMI Limited, and particularly not with that of the non-United Kingdom subsidiaries of EMI, which defendants would consolidate with Capitol. We recognize that the Court is unlikely to believe that it should review this case in order to determine the proper application of its two recent decisions where they have not been considered below, or by the California tax authorities for that matter, but we believe that if the Court does grant certiorari it may wish to preserve this issue as one possibly to consider.

CONCLUSION

This case represents the ideal vehicle for this Court's consideration of the constitutional status, under the United States Constitution and International Law, of the combined unitary formula used by California and certain other states, in the application where a domestic subsidiary is combined with a group of foreign corporations, including the parent corporation, who do not have permanent establishments in the United States, and a mathematically determined percentage of the total income of the group is assigned to the domestic subsidiary for taxation. This is done here without regard to the absence of any over-reaching or other conduct which could have the effect of improperly shifting income from the subsidiary to the foreign sources, and the fact any irregularities could be adequately dealt with by the internationally accepted arm's-length method. This case would expand the scope of this Court's consideration of the *Container Corporation of America v. Franchise Tax Board*, No. 81-523, to include a domestic subsidiary of a foreign parent, and thus provide the Court with a vehicle

suitable for considering fully the objections of the foreign nations to California's departure from established international custom, and California's double taxation of income already fully taxed in the host or parent country.

We believe the procedural objection the Court of Appeals found should not deter the Court, because it is plainly based on a serious fallacy, which fallacy is that the Federal Courts can tell the California courts how to interpret to their own judicially created doctrines of exhaustion of administrative remedies. The evidence provided by the State courts is what must be considered, and that evidence shows that those courts are expanding the doctrine and would probably prevent petitioner from having a full trial, with all issues considered, including both those of constitutional law and of fact, in a manner to satisfy the requirements of due process for a trial de novo. There is, therefore, not a "plain, . . . efficient" remedy in the State courts, and the Federal courts have not been ousted of jurisdiction by Section 1341. Since the facts of this case are unusual, agreement with our position on this point will not open the floodgates in California cases. Moreover, it might well cause the California courts to rethink their judicially erected barriers to "efficient remedy".

Accordingly, the Writ of Certiorari should be granted.

Respectfully submitted,

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(Appendices follow)